

ORIGINAL

NECA NATIONAL EXCHANGE
CARRIER ASSOCIATION

EX PARTE OR LATE FILED

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Gina Harrison
Senior Counsel and Director

Washington Office

RECEIVED

JAN 27 2000

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

January 27, 2000

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
The Portals
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: **Ex Parte Notice:** CC Docket No. 99-36, In the Matter Of
NECA's Cost and Data Review Process

Dear Ms. Salas:

Today, Rich Snopkowski - Vice President Industry Relations, Larry Sampson - Eastern Region Director, and I, all of NECA, met with Judy Nitsche - Chief, Tariff and Pricing Analysis Branch, Rich Lerner - Deputy Chief, Competitive Pricing Division, Renee Terry and Rodney McDonald to discuss the points summarized in Attachment A. In addition, other materials were distributed (Attachments B, C, and D).

In accordance with Commission rules, I am submitting two copies of this notice. Kindly stamp the additional return copy provided. Please direct any questions to me.

Sincerely,

Gina Harrison


Attachments

No. of Copies rec'd 042
List ABCDE

CC: Rich Lerner
Rodney McDonald
Judy Nitsche
Renee Terry

NECA'S COST AND DATA REVIEW PROCESS

RECEIVED
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

CC Docket No. 99-36
January 27, 2000

NECA'S REVIEW GUARDS AGAINST ABUSES

I. NECA'S COST STUDY PROCESS

- A. NECA scrutinizes all cost studies for Part 32, 64, 36 and 69 compliance.
 - Verifies the carrier's common line revenue requirement
 - Exposes any potential violations, including problematic affiliate transactions

- B. NECA routinely challenges questionable charges and directs recalculation of carrier's revenue requirement. See, e.g., Memorandum Opinion & Order, AAD 95-119 (released February 5, 1996) (tax disallowance); Memorandum Opinion and Order, AAD 90-19 (released October 15, 1990) (tax-related disallowance)

NECA'S REVIEW GUARDS AGAINST ABUSES

II. NECA's UNIVERSAL SERVICE DATA COLLECTION

A. NECA cross-checks common line pool cost studies against the data carriers submit for universal service reimbursement.

- inconsistent reporting detected

B. NECA performs due diligence examination of submitted expense and investment figures.

- exposes anomalies, such as those potentially caused by affiliate transactions

NECA'S REVIEW GUARDS AGAINST ABUSES

III. NECA's cost study review and universal service data verification are necessary to ensure that pool members are treated fairly and in conformity with all legal and regulatory requirements.

- NECA cannot allow one carrier an unfair advantage over others, for the sake of the viability of the the entire pool
- The constraints of pool participation and surveillance provide a sure check on any potential cross-subsidization or other similarly improper behavior

CONCLUSIONS

- NECA's responsibilities under the pool's revenue distribution agreement and its underlying obligation to treat all pool members fairly safeguards against cross-subsidy and other abuses.
- Good cause exists for granting PRTC a waiver to remain in the NECA Common Line pool.

AGREEMENT FOR THE DISTRIBUTION
OF
INTERSTATE ACCESS REVENUES
(Cost Companies)

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This Agreement, is made, effective as of May 5, 1994 between the National Exchange Carrier Association, Inc. herein called the Association, a non-profit corporation organized under the laws of the State of Delaware, and Puerto Rico Telephone Company, herein called PRTC, a corporation organized under the laws of the State of Delaware.

WHEREAS, Puerto Rico Telephone Company (PRTC) is a member of the Association and the terms of its membership are governed by an Agreement dated as of October 1, 1985, and

WHEREAS, Puerto Rico Communications Corporation (PRCC) has been a member of the Association and the terms of its membership have been governed by an Agreement dated as of October 1, 1985, and

WHEREAS, Puerto Rico Telephone Company has acquired the assets of Puerto Rico Communications Corporation, and

WHEREAS, the former operations of PRCC will continue to be maintained as a separate study area, known as Puerto Rico Telephone Company- Central, and will not be combined with the preexisting study area of PRTC (herein called the pre-merger PRTC study area):

WHEREAS, the parties desire to set forth the terms and conditions for the participation by Puerto Rico Telephone Company- Central (herein called the Exchange Carrier) in certain interstate access service revenue pooling and distribution arrangements: and

WHEREAS, this Agreement is intended to supersede the Agreement between the Association and PRCC dated as of October 1, 1985, but is not intended to affect the terms of the Agreement dated as of October 1, 1985 between the Association and PRTC with regard to the pre-merger PRTC study area: and

WHEREAS, exchange carriers and the Association were ordered by the Federal Communications Commission (herein FCC) in CC Docket No. 78-72 to file interstate exchange access tariffs in compliance with Part 69 of the FCC's Rules; and

WHEREAS, the establishment of uniform pooling methodology and administrative guidelines is essential to the FCC-ordered distribution of revenues among exchange carriers and to assure the appropriate flow of funds among exchange carriers; and

WHEREAS, it is to the benefit of exchange carriers for the Association to effectuate payments among exchange carriers on a monthly basis; and that such payments should recover for each Exchange Carrier its monthly interstate access expenses and provide a common return by pool on its interstate access investment;

NOW THEREFORE, in consideration of the mutual covenants, agreements and undertakings set forth herein the parties agree as follows:

SECTION I

SCOPE OF THE AGREEMENT

This Agreement describes terms and conditions for the pooling and distribution of the interstate access revenues for the pool (s) in which the Exchange Carrier participates and as provided in Part 69 of Title 47 of the Code of Federal Regulations and as agreed to by both parties in this Agreement.

SECTION II

COMPLIANCE WITH FCC RULES AND REGULATIONS

With respect to all matters covered by this Agreement, the Exchange Carrier and Association shall comply with all applicable FCC Orders, Rules and Regulations, as may be modified from time to time by the FCC.

SECTION III

RESPONSIBILITIES OF PARTIES

A. Exchange Carrier

1. Reporting of Data for Revenue Distribution

The Exchange Carrier shall be responsible for the gathering, accuracy and reporting of all data in such form and at such times as may be reasonably required by the Association for purposes of effectuating monthly revenue distributions. The Exchange Carrier agrees to make available additional supporting documentation as may be reasonably required by the Association to resolve questions concerning reported data.

2. Bank Account Information

The Exchange Carrier agrees to provide information as necessary to the Treasurer of the Association with regard to the Exchange Carrier's bank and account into which payments are to be made to the Exchange Carrier. Such information shall be treated as proprietary information as stipulated in Section VIII of this Agreement.

B. Association

1. Tariff Filing

To the extent the Exchange Carrier participates in common tariff arrangements filed by the Association, the Association will monitor revenues, revenue requirements, and usage data related to Association filed tariffs. Should any change in circumstances warrant, the Association will take appropriate action, which would include consideration of tariff revisions to reflect changed conditions.

2. Settlement

The Association shall prepare and furnish to each Exchange Carrier a monthly settlement statement detailing the net amount due to or due from the Exchange Carrier and will effect required cash flows in accordance with Schedules published by the Association. The current schedule is set forth in Attachment I. The Association shall provide at least sixty (60) days notice prior to the date upon which any modification to this or any subsequent schedule takes effect. The method of payment by the Exchange Carrier to the Association, or from the Association to the Exchange Carrier, shall occur in accordance with Section V.

Notwithstanding any other provision in Sections IV, V, and IX of this Agreement, the Association's obligation to make payments under this Agreement and the timing of such payments is limited to the funds received by the Association, less reimbursement for Association expenses, from all members of the Association.

3. Cash Flow Contingency

To the extent that funds available to the Association, including borrowings, for making payment to exchange carriers are insufficient to satisfy net amounts due exchange carriers, the Association shall, in a manner consistent with the FCC's Rules and Regulations, distribute a pro-rata share of available funds to exchange carriers. If such distribution is made, the Exchange Carrier's pro-rata share shall be computed by determining the ratio of funds available to the total net amount due exchange carriers, and then applying this ratio against the individual Exchange Carrier's net amount due. Remaining balances of net amounts due the

Exchange Carrier resulting from this calculation shall be reflected in the following data month's cash flow calculation.

SECTION IV

REVENUE SETTLEMENTS PROCESS

A. The term "settlement", as used herein, shall mean the reimbursement of expenses, taxes, and share of residue for each pool in which the Exchange Carrier participates from the available pooled revenues after deducting Net Realized Uncollectibles. The term "net balance" represents the required cash flow between the Association and the Exchange Carrier and is determined by deducting the revenues earned and reported by the Exchange Carrier, from the settlement due the Exchange Carrier. If as a result of this calculation the Exchange Carrier has a negative net balance, i.e., owes money to the pool, the Association shall render a bill for that amount to the Exchange Carrier. If the Exchange Carrier has a positive net balance, i.e., due money from the pool, the Association shall disburse that amount to the Exchange Carrier, except as otherwise provided for in this Agreement.

B. In computing Exchange Carrier settlements and net balances, the Association shall:

1. Calculate access service settlements and net balances for each Exchange Carrier settling on the basis of nationwide "average schedules" using the formula as approved by the FCC.

2. Develop access service settlements for each Exchange Carrier settling on an individual cost basis (cost company). These settlements and net balances for each cost company shall be computed

individually for each access pool in which the Exchange Carrier participates. After first deducting Association expenses in a manner consistent with the FCC's Rules and Regulations and, secondly, after average schedule companies settlements have been determined for each of the access pools, cost company settlements will then be determined as follows:

a. For non-traffic sensitive "common line" (CL) revenue requirements, a total settlement representing both carrier common line and end user elements is computed which reimburses the Exchange Carrier for its operating expenses and taxes and provides the Exchange Carrier with its share of the remaining CL pooled revenue ("residue") based on its share of the net investment devoted to the common line elements. Subsequent to the calculation of the Exchange Carriers total common line settlement, individual amounts are calculated for the carrier common line and end user elements by equating the end user revenue requirement to the Exchange Carrier's end user revenues, and then deducting such end user revenue requirement from the total common line settlement to derive the carrier common line settlement. The Exchange Carrier is required to report to the Association end user revenues, provided however, that if the Exchange Carrier files its own end user tariff, it shall not report either the end user revenues or base factor portion investment and expense when it certifies in writing to the Association that its end user revenues fully recover its base factor revenue requirement (i.e., zero residual). Such certification shall be in the form of a letter to the NECA Pool Administrator from a duly authorized officer of the Exchange Carrier.

b. If the Exchange Carrier participates in the traffic sensitive pool, a settlement is computed which reimburses the Exchange Carrier for its operating expenses and taxes and provides the Exchange Carrier with its share of the remaining pooled revenues ("residue") based on its share of the net investment devoted to traffic sensitive pooled services.

c. If the Exchange Carrier participates in the billing and collection pool, a settlement is computed which reimburses the Exchange Carrier for its operating expenses and taxes and provides the Exchange Carrier with its share of the remaining pooled revenues ("residue") based on its share of the net investment devoted to billing and collection pooled services.

3. Render invoices to exchange carriers having negative net balances and distribute revenues to exchange carriers having positive net balances according to the schedule published by the Association, as referenced in Section III,B,2.

4. Reflect retroactive adjustments to pooling data reported by exchange carriers or the Association in order to true up and/or correct previously computed settlements for up to 24 months following the data month to which the adjustment applies.

SECTION V

TREASURY OPERATIONS

Revenue billing, collections, and disbursement shall occur in accordance with the following and on the dates specified in Attachment I:

A. Billing Statements:

Billing statements shall be rendered to the Exchange Carrier by the Association on the sixth workday of the month following the data month. These statements shall reflect the amount billed the previous month, any collections or billing adjustments, any late payment charges, the current data month net balance, and the total amount due the Association. Any collections received by the Association after the third workday will not be reflected on the current billing statement.

B. Collections:

1. Payments due the Association of greater than \$50,000 shall be made by wire transfer or electronic funds transfer directly to the Association's bank account on the fourth from last workday of the month following the data month. (See Attachment I). If this due date is a local bank holiday, funds shall be wire transferred or electronic funds transferred on the prior workday.

2. Payments of \$50,000 or less may be paid via check and mailed in time to arrive at the Association's designated lockbox location no later than the fourth from last workday of the month following the data month. (See Attachment I).

3. A late payment charge may be assessed by the Association to the Exchange Carrier for a delinquent payment. The late factor shall be the average interest rate (in decimal value) which the Association experienced for borrowing during the period in which the payment was delinquent, applied for the number of days from the payment due date up to and including the date that the payment is actually received by the Association.

Any such late payment penalties collected by the Association shall be used to offset the borrowing costs occasioned by that late payment.

C. Disbursements:

1. Payments due to the Exchange Carrier will be made via electronic funds transfer on the last workday of the month following the data month.

2. If the receiving Exchange Carrier specifically refuses to accept electronic funds transfer or if electronic funds transfer to an Exchange Carrier is technically not feasible, payment will be made by check mailed two business days in advance of the due date.

SECTION VI

FIDUCIARY POSSESSION OF MONIES

A. All revenues collected and held by the Association, including appreciation and interest derived from such amounts, are held by the Association in a fiduciary capacity on behalf of the parties having an interest in such monies. Parties having an interest in such monies are the members of the Association, and the Association for its operating costs.

B. All monies received by the Association and investment instruments in which such monies may be invested shall be held in the possession of the Association or in an account in the Association's name. Any such bank account (s) shall be a special purpose account (s) which shall contain only amounts related to pooled revenues and appreciation and interest derived from such amounts and investment instruments representing investments of

such amounts, and shall be used only as set forth in the next paragraph.

C. Monies held by the Association shall be used first to pay, on a current monthly basis, the Association's expenses, including all amounts the Association requires to pay in interest and principal on borrowings incurred by the Association in order to effectuate revenue distributions to members and/or to finance Association operations, and second, to distribute revenues to the Exchange Carrier as otherwise provided herein.

SECTION VII

AUDITS AND REVIEWS

The Exchange Carrier and the Association shall maintain adequate records of its transactions relative to the Agreement. Such records shall be subject to examination by the Association to the extent necessary to verify the accuracy and reasonableness of the revenues and the investment, expenses and taxes underlying the compensation amounts. The examination shall require access to the Exchange Carrier's records, properties and personnel that are reasonably necessary and relevant to the pool (s) participated in by the Exchange Carrier.

The Exchange Carrier shall at its own expense have the right to perform audits and reviews of the Association's records necessary to verify the accuracy and reasonableness of its compensation. The Exchange Carrier shall have access to such records, properties and personnel that are reasonably necessary and relevant to the pool (s) participated in by the Exchange Carrier, provided however, that the

Exchange Carrier shall not be permitted access to proprietary information of another member of the Association.

Adequate written notice shall be given to the Exchange Carrier or Association for any on-premises examination of records or amounts. Record retention for all matters applicable to the audits and reviews should be in conformance with FCC Rules and Regulations.

SECTION VIII

PROPRIETARY INFORMATION

Any information disclosed by the Exchange Carrier to the Association pursuant to this Agreement shall be used by the Association solely for the purposes of administering and otherwise implementing the terms of this Agreement. Information relating to the distribution of pooled access charge revenues provided under this Agreement shall be held in confidence by the Association and its employees, contractors or agents. Except as provided for in Section VII of this agreement, the Association shall not disseminate or release material furnished by an Exchange Carrier containing company specific information to other than its employees, contractors or agents, unless otherwise agreed upon in writing. However, nothing in this Section shall require the Association to keep confidential any information which is publicly available.

In addition, the Association agrees to give notice to the Exchange Carrier of any demands to disclose or provide any company specific information provided to the Association in conjunction with distribution of pooled access charge revenues under lawful process, unless lawfully restrained from doing so, prior to disclosing or

furnishing such information, and agrees to cooperate in seeking reasonable protective arrangements requested by the Exchange Carrier. In addition, the Association may disclose or provide information of an Exchange Carrier required under lawful order by a government agency having requisite jurisdiction; provided that the Association agrees to use its best efforts to obtain protective arrangements satisfactory to the Exchange Carrier owning the information; and provided further that the Exchange Carrier owning the information may not unreasonably withhold approval of the protective arrangements.

SECTION IX

NON-COMPLIANCE

In addition to all other remedies provided for in this Agreement or in law:

1. A failure by the Exchange Carrier to remit any funds due the Association under this Agreement shall result in an assessment of a late payment charge and adjustments to subsequent settlement cash flow to the Exchange Carrier.

2. Failure by the Exchange Carrier to report pooling data as specified in Sections III and IV shall result in the Association using for settlement computation and revenue distribution purposes, at its option, either 1) the Exchange Carrier's forecast, or 2) data which the Association has estimated on behalf of the Exchange Carrier or 3) actual historical settlement data of the Exchange Carrier. Should the Exchange Carrier fail to report any required monthly pooling data for three (3) data months, net amounts due the

Exchange Carrier from the Association may be withheld until all required past due pooling data is reported.

SECTION X

DISPUTE RESOLUTION

While it is the intention of the parties to informally resolve disputes arising hereinunder, the parties reserve their rights and remedies in law to institute any appropriate proceeding (s) to resolve disputes.

SECTION XI

MISCELLANEOUS PROVISIONS

A. Amendments

Except as required by Order of the FCC, this Agreement may not be modified without the written consent of the Exchange Carrier and the Association Board of Directors.

B. Assignment

This Agreement may not be assigned or transferred by either party without the written consent of the other party, which shall not be unreasonably withheld.

C. Entire Agreement

This Agreement, including the Attachment hereto, constitutes the entire agreement among the parties with respect to the subject matter contained herein.

D. Successors and Assigns

This Agreement shall inure to the benefit of and shall be binding upon the parties hereto and their respective heirs, successors, legal representatives and assigns.

E. Waiver

No waiver of any breach or default of this Agreement by either party hereto shall be considered to be a waiver of any other breach or default of the Agreement.

F. Notices

All notices hereunder shall be deemed to have been duly given when made in writing and delivered in person or deposited in the United States certified mail postage prepaid, return receipt requested. The addresses set forth below for the respective parties shall be the places where notices shall be sent, unless written notice of a change of address is given.

NECA

National Exchange Carrier Association, Inc.

Vice President - Eastern U.S.

100 So. Jefferson Road

Whippany, NJ 07981

Exchange Carrier

Name: Puerto Rico Telephone Company- Central (formerly PRCA)

Address: G.P.O. Box 998

San Juan, PR 00936

G. Severability

If any of the provisions of this Agreement shall be invalid or unenforceable, such invalidity or unenforceability shall not invalidate or render unenforceable the entire Agreement, but rather the entire Agreement shall be construed as if not containing the particular invalid or unenforceable provision or provisions and rights and obligations of the parties shall be construed and enforced accordingly.

H. Counterparts

This Agreement may be executed in any number of counterparts, each of which shall be an original; but such counterparts shall together constitute but one and the same instrument.

I. Caption Headings

The headings in this Agreement are for convenience only and shall not be construed to define or limit any of the terms herein or affect the meaning or interpretation of this Agreement.

J. Force Majeure

Neither Party shall be held liable for any delay or failure in performance of any part of this agreement from any cause beyond its control or without its fault or negligence such as acts of God, acts of civil or military authorities, war or unusually severe weather conditions.

K. Prior Agreements

This Agreement supersedes all prior Agreements for the distribution of access revenues. Further, all retroactive adjustments to settlements made pursuant to the 1984/1985 Agreement

For The Distribution of Interstate Access Revenues shall be governed by the provision of this Agreement.

SECTION XII

TERMINATION

This Agreement shall be effective for the next access period, and shall renew automatically thereafter for each subsequent access period unless either party to the Agreement provides the other with written notification of its intention to terminate the Agreement by not later than 90 days prior to the expiration of the access period then in effect. As used herein, an access period shall coincide with the period in which an Exchange Carrier may enter or exit association common tariff arrangements in accordance with Section 69.3 of the FCC's Rules.

Notwithstanding termination of this Agreement, the Exchange Carrier and the Association shall continue to be bound by the terms of this Agreement for all adjustments relative to the Revenue Settlements Process as specified in Section IV.

IN WITNESS WHEREOF, the parties have caused the Agreement to be executed in duplicate on their behalf this 5th day of May 1994.

Company: National Exchange Carrier Association, Inc.

By: *[Signature]*

Title: Vice President - Eastern U. S.

Company: Puerto Rico Telephone Company - Central (formerly PRCA)

By: *[Signature]* AGUSTIN GARCIA ACEVEDO 9/21/94

Title : PRESIDENT

gbo

Section 2
The Settlement CyclePool Administration Procedures
Cost Company


Exhibit 2.2

COST
NECA SETTLEMENT SCHEDULE FOR 1994/1995

DATA MONTH	Pooling Input May Begin As Early as 5th Workday of the Data Month*	Mailed Pooling In- put Due To NECA Reg. Office on 5th Last Workday of the Data Month*	Data Term. Pooling In- put Due to NECA Hqtr On 3rd Last Workday of the Data Month*	Settlement Statements From NECA On 3rd Work- day of Follow- ing Month*	Settlement Cash Flow To NECA By	From NECA By
1994						
Jan.	Jan. 7	Jan. 25	Jan. 27	Feb. 3	Feb. 23	Feb. 28
Feb.	Feb. 7	Feb. 22	Feb. 24	Mar. 3	Mar. 28	Mar. 31
Mar.	Mar. 7	Mar. 25	Mar. 29	Apr. 5	Apr. 26	Apr. 29
Apr.	Apr. 7	Apr. 25	Apr. 27	May 4	May 25	May 31
May	May 6	May 24	May 26	Jun. 3	Jun. 27	Jun. 30
Jun.	Jun. 7	Jun. 24	Jun. 28	Jul. 6	Jul. 26	Jul. 29
Jul.	Jul. 8	Jul. 25	Jul. 27	Aug. 3	Aug. 26	Aug. 31
Aug.	Aug. 5	Aug. 25	Aug. 29	Sep. 6	Sep. 27	Sep. 30
Sep.	Sep. 8	Sep. 26	Sep. 28	Oct. 5	Oct. 26	Oct. 31
Oct.	Oct. 7	Oct. 25	Oct. 27	Nov. 3	Nov. 23	Nov. 30
Nov.	Nov. 7	Nov. 22	Nov. 28	Dec. 5	Dec. 27	Dec. 30
Dec.	Dec. 7	Dec. 23	Dec. 28	Jan. 5	Jan. 26	Jan. 31
1995						
Jan.	Jan. 9	Jan. 25	Jan. 27	Feb. 3	Feb. 23	Feb. 28
Feb.	Feb. 7	Feb. 22	Feb. 24	Mar. 3	Mar. 28	Mar. 31
Mar.	Mar. 7	Mar. 27	Mar. 29	Apr. 5	Apr. 25	Apr. 28
Apr.	Apr. 7	Apr. 24	Apr. 26	May 3	May 25	May 31
May	May 5	May 24	May 26	Jun. 5	Jun. 27	Jun. 30
Jun.	Jun. 7	Jun. 26	Jun. 28	Jul. 6	Jul. 26	Jul. 31
Jul.	Jul. 10	Jul. 25	Jul. 27	Aug. 3	Aug. 28	Aug. 31
Aug.	Aug. 7	Aug. 25	Aug. 29	Sep. 6	Sep. 26	Sep. 29
Sep.	Sep. 8	Sep. 25	Sep. 27	Oct. 4	Oct. 26	Oct. 31
Oct.	Oct. 6	Oct. 25	Oct. 27	Nov. 3	Nov. 27	Nov. 30
Nov.	Nov. 7	Nov. 22	Nov. 28	Dec. 5	Dec. 26	Dec. 29
Dec.	Dec. 7	Dec. 21	Dec. 27	Jan. 4	Jan. 26	Jan. 31

Add

*NOTE: Dates based on NECA workdays

 Subsequent year

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

VIRGIN ISLANDS
TELEPHONE
CORPORATION

AAD 90-19

Request for Declaratory Ruling
Concerning the Proper Treatment
of Certain Interest Expense Under
Parts 32 and 64 of the
Commission's Rules

NECA OFFICIAL
LIBRARY COPY
(If Properly Not Resub)
Date Rec'd

MEMORANDUM OPINION AND ORDER

Adopted: October 5, 1990;

Released: October 15, 1990

By the Chief, Common Carrier Bureau:

I. INTRODUCTION AND BACKGROUND

1. On May 7, 1990, the Virgin Islands Telephone Corporation (VITELCO) filed a Request for Declaratory Ruling concerning the regulatory treatment of interest expense associated with a loan used in the acquisition of VITELCO by its parent company. VITELCO requests this ruling to resolve a controversy between itself and the National Exchange Carrier Association (NECA), which prepares VITELCO's interstate access tariffs.¹ By this Order we determine that the interest expense on VITELCO's books must be included in the calculation of its federal income tax expenses in determining its interstate revenue requirements.

2. In June of 1987, the Atlantic Tele-Network Company (ATN) purchased 100% of the stock of VITELCO from the ITT Corporation. As part of the financing for this stock purchase, ATN arranged for a bridge loan from E.F. Hutton in the amount of \$94 million. At the date of the acquisition, VITELCO had no long-term debt. On December 30, 1987, ATN entered into a borrowing arrangement with the Rural Telephone Finance Cooperative (RTFC)² in order to replace the bridge loan with permanent financing. ATN borrowed \$104 million from the RTFC. Under the terms of the loan agreement, \$60 million of the \$104 million in loan proceeds were lent to, and recorded on the books of, VITELCO and the remaining amount was recorded on ATN's books. For the \$60 million of debt incurred by VITELCO, it received \$49.6 million in cash and \$10.4 million in RTFC Subordinated Capital Certificates. On December 30, 1987, VITELCO paid a dividend to ATN in the amount of \$49.6 million in order to permit ATN to repay the bridge loan. Pursuant to a settlement with the Virgin Islands Public Services Commission in connection with certain rate proceedings, on December 31, 1988, VITELCO transferred \$4.4 million of the RTFC Subordinated Capital Certificates to ATN in exchange for a 10% promissory note from ATN due January 1, 1990. As a result of this transaction,

VITELCO is left with \$6 million of Subordinated Capital Certificates recorded on its books. VITELCO filed the Request for Declaratory Ruling because VITELCO and NECA were unsuccessful in their attempts to resolve the controversy as to the proper ratemaking treatment of VITELCO's interest expense on the RTFC loan.

II. POSITIONS OF THE PARTIES

3. The dispute between VITELCO and NECA involves the proper treatment of interest expense on the portion of the RTFC loan recorded on VITELCO's books beginning in 1988 and the treatment of income from the RTFC Subordinated Capital Certificates. VITELCO contends that the interest expense attributable to the loan recorded on its books should not be included in the determination of the interstate portion of Federal Income Tax expenses (FIT) for revenue requirement calculation purposes. NECA contends that the interest expense should be treated as an FIT deduction for purposes of interstate access revenue requirements and NECA settlements.³ NECA also believes the Commission's Part 32 accounting rules do not allow the use of income from the RTFC Subordinated Capital Certificates to be offset against the interest expense.⁴ Until this dispute is resolved, VITELCO has been making voluntary monthly adjustments to its 1988 settlements with NECA. In addition to a ruling that its proposed regulatory treatment of ATN loan interest expense is correct, VITELCO requests the Commission to direct NECA to refund these voluntary monthly adjustments.

4. VITELCO claims that ATN's acquisition of its stock is a nonregulated transaction and, in accordance with Parts 32 and 64 of the Commission's rules,⁵ the interest expense on the related borrowing should not be included in ratemaking. VITELCO claims that ATN's loan to purchase VITELCO's stock (the bridge loan) was not used for plant construction or to pay expenses incurred in the provision of telephone service and, therefore, the related interest expense was not associated with regulated telephone operations. VITELCO contends that the interest expense recorded on its books that relate to the RTFC loan is solely attributable to ATN's purchase of VITELCO's common stock. Under these circumstances, this interest expense is directly assignable to ATN and should not be included in the calculation of FIT for interstate access revenue requirement purposes.⁶ VITELCO maintains that the interest expense on ATN's bridge loan was properly excluded from VITELCO's cost of service determinations and that NECA did not disagree with this ratemaking treatment. VITELCO further argues that since both loans were obtained for the same purpose, it would be illogical to distinguish the ratemaking treatment in the manner NECA suggests.⁷ Along with its filing, VITELCO includes letters from the independent accounting firms of Coopers & Lybrand and Deloitte & Touche, which support its position.⁸

5. NECA commented on VITELCO's request on May 17, 1990. NECA explains that under its pooling procedures, tariff participants receive settlements that include an allowance for FIT expenses. It states that in accordance with FCC accounting rules, it requires companies to report interest expense on debt as a deduction prior to calculating the FIT portion of settlements. NECA states that the dispute concerns whether or not the interest expense at issue here relates to regulated activity.⁹

6. NECA contends that the record clearly shows that the RTFC loan was used to acquire regulated telephone plant, and is secured by a mortgage on that plant. NECA also contends that it appears from VITELCO's financial statements that as of December 1988, the ability of ATN to service the RTFC borrowing was solely dependent on funds from VITELCO's regulated operations. NECA believes that while the RTFC loan was not used to finance "new construction", it was used to acquire existing telephone plant. NECA states that the interest expense is properly recorded on VITELCO's books and therefore must be included in VITELCO's cost study as a deduction for FIT calculation purposes. NECA points out that a Commission holding which fails to properly recognize this transaction as part of FIT calculations could allow any company that has exchanged equity for debt to claim "phantom" income tax reimbursements from interstate ratepayers without regard to whether taxes actually are owed by the company.¹⁰

7. NECA adds that if the RTFC interest expense is included in determining its FIT allowance, the income from the RTFC Subordinated Capital Certificates should not be treated as a reduction of the effective interest rate or a refund of the interest expense which RTFC has charged VITELCO on its loan. NECA contends that this accounting treatment is not supported by Part 32 of the Commission's rules. NECA believes that the interest expense is properly recorded in Account 7500, Interest and Related Items. NECA also believes that according to the description of entries to be included in Account 7500, interest expenses are not to be offset by investment related income. NECA suggests that such income should be booked in Account 7300, Nonoperating income and expense, which is used to record amounts received from investments in nonaffiliated companies. Nonaffiliated companies are treated as nonregulated investments.¹¹ NECA concludes that there is no basis in the rules for netting the income against the interest expense associated with the RTFC loan.¹² NECA includes with its comments a statement from the independent accounting firm of Ernst and Young which supports its position.¹³

III. DISCUSSION

8. We have considered the positions of VITELCO and NECA regarding the appropriate ratemaking treatment for the interest expense relating to the RTFC loan. We conclude that the interest expense on VITELCO's books should be treated as a deduction in the calculation of FIT for purposes of interstate access revenue requirements and NECA settlements as provided in Part 36.¹⁴ In addition, the interest income relating to the RTFC Subordinated Capital Certificates should not be used as an offset to VITELCO's interest expense.

9. We cannot agree with VITELCO's claim that the debt recorded on its books is unrelated to its telephone operations. The effect of VITELCO's recording of this debt and reducing its equity by payment of a dividend to ATN leaves VITELCO financed almost entirely by debt. Even a cursory review of VITELCO's balance sheet indicates that virtually all of its assets, except for the RTFC Certificates, are regulated plant and that those assets have been financed almost entirely by debt. Moreover, the relationship between VITELCO's regulated plant and its debt is further supported by the fact that VITELCO's regulated plant has been pledged as security for the debt.

10. Finally, the income from the RTFC Subordinated Capital Certificates should not be offset against the interest expense related to the loan. The income from these certificates should be recorded in Account 7300, Nonoperating Income and Expense along with interest income from other securities and evidences of indebtedness, which are the property of the company.¹⁵ The RTFC Subordinated Capital Certificates are a nonregulated investment which shall not be included in VITELCO's rate base. Accordingly, the related income should be treated as nonoperating income.¹⁶ Although the interest expense cannot be reduced by the income on the RTFC Subordinated Capital Certificates, we note that not all of the interest expense would be used in the FIT calculations. Under Part 36, interest expense related to nonoperating net investment such as the RTFC Subordinated Capital Certificates would be excluded.¹⁷

IV. ORDERING CLAUSE

11. Accordingly, IT IS ORDERED pursuant to Sections 4 (i) and 220 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154 (i) and 220, That the interest expense relating to the RTFC loan on VITELCO's books must be included in the determination of Federal Income Taxes for the purpose of determining interstate revenue requirements, and that the interest income from the RTFC Subordinated Capital Certificates should be recorded in Account 7300, Nonoperating Income and Expense and excluded from determinations of interstate revenue requirements.

FEDERAL COMMUNICATIONS COMMISSION

Richard M. Firestone
Chief, Common Carrier Bureau

FOOTNOTES

¹ NECA prepares and files access tariffs on behalf of telephone companies that do not file separate tariffs or concur in a joint access tariff of another telephone company. NECA also pools access revenues and distributes these revenues to pool participants.

² RTFC is a cooperative that offers financing programs and services to rural telephone companies and cooperatives. It is affiliated with the National Rural Utilities Cooperative Finance Corporation.

³ When interest expenses are included in the calculation of FIT, the taxable income to which the tax rates are applied becomes smaller, resulting in a lower tax expense component in revenue requirement calculations.

⁴ 47 C.F.R. Part 32.

⁵ *Id.* and 47 C.F.R. Section 64.901 *et. seq.*

⁶ VITELCO Request at 5.

⁷ *Id.* at 6.

⁸ *Id.*, Attachment C and D.

⁹ NECA Comments at 4-5.

¹⁰ *Id.* at 5-6.

¹¹ See 47 C.F.R. Sections 32.7500 and 32.7300.

¹² *Id.* at 7-8.

¹³ *Id.*, Appendix A.

¹⁴ See 47 C.F.R. Section 36.412 (b)(4)(i).

¹⁵ See 47 C.F.R. Sections 32.7300 and 32.7320.

¹⁶ Investments of this type that are allowed in the rate base are limited to Class B Rural Telephone Bank Stock. See 47 C.F.R. Section 36.172 and 4 FCC Red 1697 (1989).

¹⁷ See 47 C.F.R. Section 36.412(b)(4)(i).

100 South Jefferson Road
Whippany, N.J. 07981
973-884-8085
email jrick@neca.org

NECA-MIDWEST

MAR 1 1999

John A. Ricker
Executive Director
Universal Service
Program Support

March 8, 1999

RECEIVED

Magalie Roman Salas
Secretary
Federal Communications Commission
455 12th Street S.W.
TW-A325
Washington, D.C. 20554

Attention: Common Carrier Bureau

Re: Universal Service Fund Data Collection

On October 1, 1998, NECA submitted the Universal Service Fund 1998 Submission of 1997 Study Results to the Federal Communications Commission in accordance with section 36.613 of the Commission's rules, 47 C.F.R. § 36.613. In that submission, NECA indicated that it was reviewing data submitted by one exchange carrier because of a significant increase in loop cost and expense adjustment for that company.¹

NECA has determined that the increase in this company's loop cost and expense adjustment data is attributable to a sale lease-back arrangement between this company and an affiliate. During 1997, the company sold its motor vehicles, other work equipment, land and buildings, furniture, office equipment, general purpose computers, circuit equipment, and buried cable (non-loop related) to the affiliate, and then leased back all of this property from the affiliate for the provision of local exchange service.

The lease-back arrangement significantly impacts the calculation of the loop cost because of its impact on the relationship between loop-related investment and total investment. The Universal Service Loop Cost algorithm uses factors to allocate total company costs to the loop for USF purposes. These factors are derived from loop related investment to total investment. When virtually all of the non-loop related investment is removed from the factor calculation through the creation of a lease-back arrangement, the cost allocation factors are significantly altered.

In 1997, for example, NECA reported a study area loop cost for this company's property of \$354.21. The assignment of costs to the loop was based on the following allocation factors: A Factor 0.8319; B Factor 0.0175; C Factor 0.1452 and D Factor 0.0040.² In the October 1, 1998 submission that reflects the introduction of the lease-back arrangement, the allocation factors are: A Factor of 0.9038; B Factor of 0.0815; C Factor of 0.4015; and D Factor of 0.0425, producing a study area loop cost of \$878.98. The lease-back arrangement results in an increase in percent of Investment, Accumulated Depreciation and Maintenance Expenses assigned to the loop of approximately 13.6 percent. The percent of the remaining expenses, taxes, rents and benefits

¹ Universal Service Fund 1998 Submission of 1997 Study Results, National Exchange Carrier Association, October 1, 1998, @ Tab 1, page 4, (Moutrie Independent Telephone Company, study area code 341060).

² *Id.* @ Tab 4. The A Factor and B Factor are used to assign Investment, Accumulated Depreciation and Maintenance Expenses to the loop, while the C and D factors are used to assign the remaining expenses, taxes, rents and benefits to the loop.

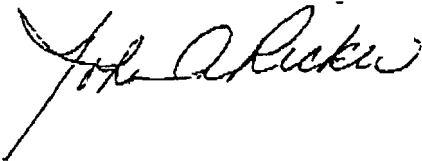
assigned to the loop goes from approximately 15 percent of those costs to over 44 percent. Thus, through the creation of an affiliate lease-back arrangement, this company realized an increase in its Universal Service funding from approximately \$15.00 per loop support per year to \$433 per loop per year.³

So far as NECA is able to determine, lease rates for the arrangement described above are in conformance with the Commission's Part 32 rules.⁴ Rather, the dramatic increase in loop cost and expense adjustment associated with this sale/lease-back transaction occur as a function of the USF algorithm and the allocation process described above. When a company sells substantially all of its non-loop investment as occurred here, and incurs substantial expenses associated with leasing that equipment back, the loop allocation factors (and USF expense adjustment levels) are driven upward regardless of whether lease rates are at market levels or fully distributed costs.

Section 36.2(c)(2) of the Commission's rules, which applies to the treatment of affiliate sale/lease-back arrangements between affiliated companies for purposes of cost separation studies, produces a different result. This provision requires that in the case of property rented from affiliates, if substantial in amount, the property and related expenses be included with, and the rent expenses excluded from, the telephone operations of the company making the separations. This essentially nullifies the effect of affiliate sale/lease-back arrangements in the separations and access charge ratemaking contexts. Since Universal Service Fund computations rely on unseparated (i.e., Part 32) investment and expense data, however, it is questionable whether the exclusion principal stated in section 36.2 can be applied to USF data.

NECA accordingly seeks a determination as to the calculation of USF expense adjustments when affiliate sale/lease-back arrangements are involved.

Should you require additional information, please contact either Mr. Tom Webb at 973 884-8067 or me.



cc: Accounting Safeguards Division
Accounting Policy Division
Ms. Cheryl Parino, USAC CEO
Ms. Heather Gold, Chair, USAC High Cost and Low Income Committee
Mr. Robert Haga, USAC Secretary-Treasurer

³ Data supporting the calculation of the allocation factors was provided on diskettes with the October 1, 1998 Submission.

⁴ Section 32.27(c) of the Commission's rules requires carriers that receive service from an affiliated company to record that service at the lower of fair market value and fully distributed costs. 47 C.F.R. § 32.27(c).

Federal Communications Commission
Common Carrier Bureau

August 4, 1999

Mr. John A. Ricker
Executive Director - Universal Service Program Support
National Exchange Carrier Association, Inc.
100 South Jefferson Road
Whippany, New Jersey 07981

Dear Mr. Ricker:

This responds to your letter dated March 8, 1999,¹ on behalf of NECA, requesting guidance on whether the calculation of loop costs and expense adjustments for Universal Service Fund ("USF") support is subject to the provisions of Part 36 that govern the treatment of sale/lease-back arrangements between affiliates.² NECA requested this guidance because an exchange carrier had used a sale/lease-back transaction with an affiliate to increase its loop costs significantly and thus its USF support payments. NECA questions whether the Part 36 treatment of sale/lease-back arrangements between affiliates is applicable to the determination of USF payments because Part 36 primarily governs jurisdictional separations procedures and USF computations are based on unseparated loop costs.

The provisions of Part 36 are not limited to jurisdictional separations. Subpart F of Part 36 governs the USF.³ Section 36.2 of Part 36 ("Fundamental principles underlying procedures")⁴ sets out the basic principles that govern the entire Part 36, including Subpart F.⁵ Consequently, the underlying principle in Section 36.2(c)(2) that governs property rented from affiliates, clearly applies to computations concerning a carrier's USF expense adjustments under Part 36. Thus, the sale/lease-back arrangement described by NECA should be accounted for as required by Section 36.2(c)(2) (i.e., by including the property and related expenses with, and excluding the related rent expenses from, the carrier's regulated telephone

¹ See Letter dated March 8, 1999 from John A. Ricker, Executive Director - Universal Service Program Support, National Exchange Carrier Association ("NECA") to Magalie Roman Salas, Secretary, Federal Communications Commission.

² See 47 C.F.R. 36.2(c)(2).

³ See 47 C.F.R. 36.601 to 36.641.

⁴ See 47 C.F.R. § 36.2(a).


⁵ In this respect, we also note that Section 36.2 applies to all Part 36 rule series -- including the 36.100, 36.300, and 36.400 series -- most of which set procedures for placing unseparated costs into categories.

*Letter to John A. Ricker
August 4, 1999
Page 2*

operations) for purposes of calculating the loop costs associated with USF expense adjustments.

If you have further questions regarding this matter, please contact JoAnn Lucanik at (202) 418-0873.

Sincerely,

A handwritten signature in dark ink, appearing to read "LZ-MZ", is written over the typed name.

Lisa Zaina, Acting Deputy
Common Carrier Bureau



8725 W. Higgins Road, Suite 444
Chicago, IL 60631
(800) 323-4953
Fax: (800) 323-8402

VIA FAX AND CERTIFIED MAIL - RETURN RECEIPT REQUESTED

August 11, 1999

Mr. Steven Bowers
President & General Manager
Moultrie Independent Telephone Company
111 State & Broadway
Lovington, IL 61937-0350

Dear Steve:

The FCC has issued a response to the NECA inquiry regarding your company's USF calculation. (These two letters are attached.) In its decision, the FCC is clear that your sale/leaseback arrangement should be accounted for as required by Sec 36.2(c)(2)..."by including the property and related expenses with and excluding the related rent expense from, the carriers regulated telephone operations."

The current USF payment level will be replaced by the amount you received from the 97-1 USF submission. This will begin with the payment you will receive on August 31, 1999. You are requested to send us a revised 98-1 USF submission in accordance with the FCC's Part 36 Rules. From this submission, we will revise your USF payment and net it against amounts received since January, 1999.

We will also need a revised 99-1 USF submission and revised 1997 and 1998 cost studies. The revised USF submissions and cost studies should be accompanied by new Certification Statements.

Sincerely,

A handwritten signature in dark ink, appearing to read "Roberta Alvir", is written over a horizontal line.

Roberta Alvir
Manager
Attachments

Cc: Larry Dale - Independent Telecomm Consultants, Inc.